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Sen. James Merritt
Sen. Beverly Gard
Sen. Greg Server
Sen. Gary Dillon
Sen. Victor Heinold
Sen. Brandt Hershman
Sen. Allie Craycraft
Sen. Larry Lutz
Sen. Earline Rogers
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Rep. William Ruppel
Rep. Matt Whetstone
Rep. James Bottorff
Rep. David Crooks
Rep. Ryan Dvorak
Rep. Win Moses
Rep. Dan Stevenson



REGULATORY FLEXIBILITY COMMITTEE

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MEETING MINUTES¹

Meeting Date: October 3, 2005
Meeting Time: 10:00 A.M.
Meeting Place: State House, 200 W. Washington St., Senate Chambers
Meeting City: Indianapolis, Indiana
Meeting Number: 2

Members Present: Sen. Thomas Wyss, Co-Chairperson; Sen. James Merritt; Sen. Beverly Gard; Sen. Greg Server; Sen. Gary Dillon; Sen. Victor Heinold; Sen. Brandt Hershman; Sen. Allie Craycraft; Sen. Larry Lutz; Sen. Earline Rogers; Rep. Jack Lutz, Co-Chairperson; Rep. James Buck; Rep. William Ruppel; Rep. Matt Whetstone; Rep. David Crooks; Rep. Ryan Dvorak; Rep. Win Moses; Rep. Dan Stevenson.

Members Absent: Sen. Connie Sipes; Rep. David Frizzell; Rep. Robert Behning; Rep. Timothy Neese; Rep. James Bottorff.

Senator Tom Wyss and Representative Jack Lutz, Co-Chairmen of the Regulatory Flexibility Committee, called the meeting to order at 10:10 a.m. Senator Wyss announced

¹ Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of \$0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is <http://www.in.gov/legislative/>. No fee is charged for viewing, downloading, or printing minutes from the Internet.

that the meeting's agenda would include testimony on telecommunications reform at the global, national, state, and local levels.

Competition in the Global Telecommunications Market

Senator Wyss invited Dr. Tom Rutledge,² Chairman of Rutledge Capital, to discuss the role of telecommunications in the competitive global marketplace. Dr. Rutledge began by announcing that telecommunications has long been evolving from a highly regulated industry to the "central nervous system" of the global economy. He then discussed the role of telecommunications and technology in determining the global competitiveness of the U.S. economy, as compared to the emerging economies of China and India.

First, Dr. Rutledge noted that capital is the key to growth in any economy. While China and India have acted aggressively to draw capital into their economies, the United States has been driving its capital resources to other countries. He explained that this "hemorrhaging" of capital is due in large part to overhead costs that are as much as 20% higher in the United States. According to Dr. Rutledge, as capital investments move to Asia, jobs and wages go with it. Noting that China consistently produces more engineers than the does the United States, Dr. Rutledge suggested that the quality of the American education and communications systems will ultimately determine the ability of the United States to compete in the global economy.

Dr. Rutledge lamented the slow pace of investment in communications infrastructure in the United States. Pointing out that broadband technology offers the fastest means of communicating currently available, Dr. Rutledge noted that highspeed broadband is consistently available only in those U.S. cities large enough to host a National Football League franchise. Dr. Rutledge suggested that until the regulatory treatment of communications services changes, the needed investment in broadband infrastructure is not likely to occur. Dr. Rutledge further predicted that recent relief legislation passed in the aftermath of Hurricanes Katrina and Rita may ultimately postpone efforts to enact national telecommunications reform legislation, as Congress directs its attention and the nation's economic resources to the rebuilding efforts. Given the uncertainty surrounding any federal reform legislation, Dr. Rutledge urged regulatory reform at the state level.

As an example of progressive state action, Dr. Rutledge pointed to comprehensive telecommunications reform legislation recently enacted in Texas. As individual providers seek to offer customers voice, data, and video applications, Dr. Rutledge explained that one significant element of the legislation is the replacement of video franchising at the municipal level with a streamlined franchising procedure at the state level. Dr. Rutledge suggested that Texas' state-level franchising will allow competitive service providers to enter the market more easily, with the need to negotiate multiple local franchises having been eliminated. He further predicted that franchising at the national level may eventually become a reality.

Representative Lutz then asked Dr. Rutledge to define what telecommunications "reform" encompasses. Dr. Rutledge cited three areas of concern identified by the United States

²See Exhibit 1.

Chamber of Commerce and suggested that these concerns should be addressed in any reform legislation. First, changes in the area of property law are needed to enable the installation of the infrastructure needed to expand America's communications network. For example, local zoning ordinances should be not be structured in a way that impedes infrastructure deployment or favors one type of technology over another. Additionally, property tax abatements or incentives may be necessary to encourage service providers to make the costly infrastructure investments that are needed to make broadband technology widely available. Restrictions on the siting of cell towers should be limited or eliminated.

In addition to property law changes, the U.S. Chamber urged pricing deregulation for communications services. According to Dr. Rutledge, economic deregulation of the industry is crucial to spurring the further deployment of services. Finally, the U.S. Chamber expressed concern about the need for more electromagnetic spectrum. However, because the allocation of spectrum is under the jurisdiction of the Federal Communications Commission, that issue cannot be addressed at the state level.

The Role of Technology in Telecommunications Reform

After Dr. Rutledge concluded his remarks, Senator Wyss asked Bret Swanson,³ Executive Editor of *Gilder Technology Report*, to discuss how emerging technologies are changing the telecommunications marketplace. Mr. Swanson reiterated Dr. Rutledge's assertions that the telecommunications industry must be viewed from a global perspective, and that highspeed communications are of strategic importance to America's position in the world economy. If these premises are accepted, Mr. Swanson suggested, then legislators should be concerned that Korea's per capita broadband capacity is 40 times greater than that of the United States, while Japan's capacity is 20 times greater, and Taiwan's is 10 to 15 times greater.

Mr. Swanson suggested that the main reason America has lagged in broadband penetration is the failure of the current regulatory scheme to encourage investment and promote competition. According to Mr. Swanson, the Telecommunications Act of 1996 (TA-96) has been a "disaster." While touted as a deregulation initiative at the time of its enactment, TA-96 has been only nominally deregulatory. However, Mr. Swanson claimed that an even more problematic aspect of continuing to use TA-96 as the nation's regulatory framework is the fact that technology has rendered its language and concepts obsolete. For example, because of when it was enacted, TA-96 does not even mention the Internet. However, Mr. Swanson warned that proposed federal reform legislation similarly risks being rendered obsolete. Calling it "disappointing," Mr. Swanson referred to a bill draft released by U.S. Rep. Joe Bardon (R-Texas). He explained that the 77-page draft creates three new, rigidly defined categories of service: (1) broadband Internet transmission service (BITS); (2) voice over Internet protocol (VOIP) service; and (3) broadband video service. According to Mr. Swanson, while the bill does contain some provisions that could be characterized as deregulatory, it includes other provisions that maintain or expand the regulatory authority of government. For example, the bill would apply content regulations that currently apply to cable operators to the new category of broadband video service providers. He also expressed concerns about the bill's "network neutrality" provisions. While meant to prevent BITS providers from degrading the service provided by VOIP providers and

³See Exhibit 2.

telecommunications carriers over the BITS providers' networks, the network neutrality provisions could result in the Federal Communications Commission (FCC) being flooded with numerous complaints brought by non-BITS providers against BITS providers.

Mr. Swanson also discussed the "Broadband Investment and Consumer Choice Act" (S. 1504) introduced by U.S. Sen. John Ensign (R-Nevada). Although criticized by some as too "simple," Mr. Swanson noted that the bill is mostly deregulatory. It eliminates all rate regulation for phone and video service, while imposing certain requirements with respect to basic local telephone service. It also provides for service quality standards to be determined by the FCC and enforced by the states. To encourage the development of needed infrastructure, the bill would prohibit local governments from charging fees for the issuance of construction permits to install or upgrade telecommunications facilities.

In addition to Congressional action, Mr. Swanson noted that telecommunications policy is also being shaped by court decisions. Mr. Swanson pointed to the United States Supreme Court's recent decision in *National Cable & Telecommunications Ass'n, et al. v. Brand X Internet Services et al.*, 125 S. Ct. 2688 (2005), in which the Court upheld the FCC's classification of broadband cable modem service as an "information service," rather than a "telecommunications service," and thus not subject to regulation as common carrier under Title II of TA-96. In response to the Court's decision, the FCC issued a regulatory announcement, which included a policy statement prohibiting the regulation of broadband Internet service by the states. Mr. Swanson noted that these determinations will necessarily affect any telecommunications reform efforts undertaken at the state level.

Noting these recent developments at the federal level, Senator Hershman asked what regulatory functions remain for state utility commissions. Mr. Swanson responded that there will still be a need for states to exercise some consumer protection functions in the near term, as the transition to a market-based system unfolds. However, he suggested that over time, the market itself will be the best protector of consumer welfare, as customers exercise their freedom to switch to another provider if they become dissatisfied with their current service.

Representative Moses asked whether it is possible to ensure universal service in a deregulated environment, if providers are no longer required to serve high cost or rural areas. Mr. Swanson answered by suggesting that the artificially low rates that result from universal service requirements have actually discouraged new investment in some service areas. According to Mr. Swanson, the artificially low rates associated with universal service have ironically disadvantaged consumers by limiting service options.

State Telecommunications Reform

Following Mr. Swanson's comments, Senator Wyss invited Ray Gifford,⁴ President of the Progress & Freedom Foundation, to speak to the Committee about telecommunications reform efforts at the state level. Mr. Gifford explained that before joining the Progress & Freedom Foundation, he served as Chairman of the Colorado Public Utilities Commission. During his four years with the Colorado Commission, Mr. Gifford observed firsthand the

⁴See Exhibit 3.

battle between incumbent local exchange carriers (ILECs) and competitive local exchanges carriers (CLECs) over issues surrounding interconnection and access to network elements. While these battles between phone companies are still being played out to some degree, Mr. Gifford has observed a new battle being waged between cable operators and telecommunications carriers over the terms and conditions of entry into local video markets. According to Mr. Gifford, this new battle has raised questions about the effectiveness and fairness of the current system of local video franchising.

Having described the new issues facing regulators, Mr. Gifford acknowledged that some state legislators and regulators are reluctant to enact state-level regulatory reforms that could soon be preempted by the adoption of new federal laws and regulations. According to Mr. Gifford, despite their apprehension, state officials cannot afford to wait to take action in the communications arena. He explained that a state's economic vitality and capacity for growth depends on its ability to offer businesses and residents a modern communications infrastructure. A state with onerous or outdated telecommunications regulations or taxing policies will be unable to attract investors willing to deploy telecommunications infrastructure. Without a highspeed communications network, the state will be further hampered in its ability to attract other businesses. To illustrate this point, Mr. Gifford related the dissatisfaction expressed by T.J. Rodgers, President and CEO of Cypress Semiconductor Corp., with the business environment in California. According to Mr. Gifford, Mr. Rodgers has complained that burdensome regulations and high taxes in California would discourage him from building additional research or production facilities in the state.

In further arguing that telecommunications reform needs to occur at the state level, Mr. Gifford expressed his disagreement with Mr. Swanson's suggestion that federal legislation is imminent. Predicting that federal action is several years away, Mr. Gifford urged the Committee to act in the meantime to make Indiana economically competitive by enacting policies that encourage investment in the state's highspeed capacity. Arguing that the current federal proposals are flawed, Mr. Gifford suggested that states that adopt successful deregulatory policies in the near term will serve as models for future federal initiatives. Such states will also position themselves favorably, in case any future federal regulations serve to preempt or limit state authority in the area.

Mr. Gifford then distributed to Committee members model state and federal legislation⁵ published by the Progress & Freedom Foundation. Encouraging legislators to review the models as they consider how to shape Indiana's communications laws, Mr. Gifford stressed that any reform legislation should offer providers freedom not only from rate and tariff regulations, but also from excessive taxes. Mr. Gifford noted that policymakers often tax activities that they want to discourage, such as alcohol and tobacco consumption. Citing these examples, Mr. Gifford asked lawmakers to consider whether the state's current tax policies are similarly discouraging the activities of communications service providers and developers.

Noting the model act's deregulatory objectives, Representative Crooks asked how state policies can ensure universal service for his largely rural district. Acknowledging

⁵See Exhibits 4 and 5.

Representative Crooks' legitimate concern, Mr. Gifford argued that by establishing artificially low rates in high-cost areas, current universal service funding mechanisms discourage new entrants from serving those areas. For example, Mr. Gifford noted that when he served as Chairman of the Colorado Public Utilities Commission, state statute mandated a monthly rate of \$14.92 for basic local service in high-cost areas. However, the average cost for a provider to deliver basic local service in those areas was \$20. As a result, except for providers subject to "carrier of last resort" obligations, landline carriers did not invest in infrastructure in those areas. Instead, wireless providers entered those markets and charged increased rates to customers who had few other service options. To address the problem of these "captive customer bases" in high-cost areas, the model act would allow a provider to "opt in" with respect to the "eligible carrier" designation that allows providers to receive state universal service fund distributions for serving high-cost areas. The model act would also allow distributions to providers regardless of the technology used to offer basic local service.

Representative Moses then posited that the goal of universal service may become increasingly difficult to achieve, given the recent spate of mergers in the communications industry. He suggested that if such consolidation continues after either the state or federal government acts to deregulate the industry, another monopoly could emerge and serve only those areas likely to generate a significant profit. Mr. Gifford responded by pointing to the current battle between telephone companies and cable operators. Instead of forming a duopoly, the two different platforms have been competing fiercely against each other, even though both remain subject to considerable regulation. Mr. Gifford suggested that in the absence of such regulation, the level of competition would grow even more intense.

Broadband Access in Rural Areas

After the discussion of reform efforts at the state level, Senator Wyss turned the Committee's attention to a local effort that has brought highspeed Internet access to rural areas in Indiana. He introduced Ron Kennedy of Fairnet,⁶ a wireless broadband company owned by the Carroll County REMC, and invited Mr. Kennedy to describe his company's accomplishments. Mr. Kennedy explained that Fairnet, which is based in Monticello, started as a dial-up Internet service provider in June 1996. In September 1999, Fairnet began testing wireless broadband service within its existing system. After being purchased by the Carroll County REMC in December 2000, Fairnet continued to develop and expand its wireless capabilities. The company now operates 50 cells that serve areas spanning 7,500 square miles in Indiana.⁷ Mr. Kennedy reported that Fairnet offers highspeed Internet access, at a speed of 256 kilobits per second upstream, for \$59 per month for residential customers. The company currently has over 5,000 customers, of which approximately 1,200 are broadband customers.

In response to a question from Senator Hume, Mr. Kennedy reported that the Carroll County REMC does not plan to offer broadband over powerlines (BPL) in the near future. However, he noted that other REMCs in the state, including those serving Jay County and

⁶See Exhibit 6.

⁷See Exhibit 7.

Wabash County, have launched efforts to offer fixed wireless broadband. Mr. Kennedy indicated that Fairnet is willing to provide these other counties with any technical advice or other assistance they might need.

In response to a question from Representative Dvorak about the extent of Fairnet's investment in its wireless system, Mr. Kennedy responded that Fairnet has invested over \$4,000,000 to develop and deploy its system. He pointed out that because the Carroll County REMC is not an REA borrower,⁸ all of the money invested has come from private sources. When asked by Senator Dillon whether Fairnet was limited to providing service within the REMC's service area, Mr. Kennedy explained that because the Carroll County REMC is not subject to the IURC's jurisdiction, the ability of Fairnet to expand is limited only by the dollars and human resources available to it.

Legislative Proposal

After all invited speakers had addressed the Committee, Representative Lutz distributed a legislative proposal⁹ for the Committee members to review before the next meeting. Representative Lutz explained that the proposal consisted of the language from HB 1518 (2005) as it passed the House on second reading. He reminded the Committee that there was bipartisan support for this language, but that the bill had failed to advance when the House ran out of time before approving it on third reading. The Co-Chairmen then concluded the meeting and announced that the Committee's final meeting would take place on October 18, 2005, at 10:00 a.m.

At that point, Representative Moses interjected to express his disappointment that meeting had featured only speakers in favor of deregulating the telecommunications industry. He suggested that meeting would have been more useful to Committee members if opposing arguments had been presented. Senator Wyss disagreed that the meeting had been one-sided but stated that Representative Moses' objections would be noted for the record. The meeting was adjourned at 12:20 p.m.

⁸Under IC 8-1-13-17, a rural electric membership corporation (REMC) is an REA borrower if it receives a loan or other financial assistance from the Rural Electrification Administration of the United States Department of Agriculture (REA).

⁹See Exhibit 8.